October 29, 1940

Chairman Eccles

Emile Despres

Attached is a memorandum prepared by Mr. Sherrard of this section reviewing "Wartime Control of Prices" by Charles O. Hardy of the Brookings Institution. Hardy's book is rather a conventional discussion of price control in war time and includes a simplified and popularized description of the methods of price regulation used during the last war. The author believes that if primary reliance is placed on monetary and fiscal controls, the most important source of price increases can be eliminated; the remaining situations can, he believes, be readily dealt with by direct controls at a few specific points. Hardy seems to us much too optimistic in thinking that the problem can be so simply and easily dealt with and that monetary and fiscal controls can carry out the major part of the job.

Attachment

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HARDY'S "WARTIME CONTROL OF PRICES"

Mr. Hardy's book is divided into two parts. The first is a discussion in general terms of the problem of wartime price control, while the second is an analysis of experience in the United States during the World War.

The discussion in Part I is centered about a distinction between price rises due to the scarcity of particular commodities and those due to a general increase of purchasing power. Hardy believes that the latter are by far the more important and that they can be prevented only by appropriate non-inflationary fiscal policy. If this has been accomplished, he feels that direct price control can safely be confined to those commodities for which Government demand is particularly heavy or the supply of which has been sharply curtailed as a result of special war or emergency conditions.

This distinction between scarcity and inflation is taken for granted throughout the book, but its nature is never explained. Upon examination it becomes blurred and tends to disappear. A general price rise is nothing but a summation of individual price rises. Each of the individual rises may be based on a shortage of that particular commodity in relation to the demand for it. (Although it may also, of course, be based on nothing more than the price-making decisions of producers.) In the same way purchasing power affects prices only as a result of specific spending acts by specific individuals. Thus the wartime price problem is one of controlling a series of scarcity situations. As armaments expenditures increase, the number of such situations will increase and a change in methods for dealing with them may be desirable. In particular, monetary instruments of control, which are necessarily of an over-all and comparatively unselective nature become appropriate when scarcity situations are the rule rather than the exception.

Hardy recognizes this in effect when pointing out that there is an important difference between circumstances now and those in 1917. When war was declared in 1917 the level of business activity in this country was already high. The defense program of 1940, on the other hand, is being inaugurated at a time of comparative depression. "The conditions which have led the United States to pursue for the past few years an expansionary credit policy without an undesirable degree of inflation may not change overnight, and until the unemployed resources of the country are substantially taken up, some expansion of the flow of money may continue to serve a useful purpose, financing output instead of merely boosting prices." (pp. 44-45)

Whether an increased expenditure stream leads to expanded output rather than higher prices does not, however, depend only upon the abundance or scarcity of resources. Business men have a good deal of discretionary control over prices in most industries, and whether they respond to anticipated prosperity by increasing output or by raising prices is determined in many cases by the attitude of Government. To assume, as Hardy does, that higher prices tend to call forth an increased supply, is to ignore the possibility in many manufacturing industries of increasing profits by raising prices and curtailing supply. The more effective control over all individual prices can be made, the more purchasing power can be expanded without incurring the evil effects associated with the word "inflation". If prices even of non-essential goods can be kept down, the flow of orders will exert a pressure on business men for increased production and will lead them to strain their resources and their ingenuity to increase output and thus maintain profits. Restraint on prices may lead to some squeezing of profit margins, but this should be offset by the expanded volume of business. By this means the time when consumption must be curtailed in the interests of defense can be postponed until resources are really being used to capacity.

Furthermore, resources in general have as little meaning as prices in general or demand in general. Resources consist of particular raw materials, particular machinery, and particular workers -- all located in particular places. Any attempt to prevent inflation by curtailing the flow of purchasing power is bound to lead to some unnecessary unemployment. A shortage of housing for shipyard workers in Newport News is not in any useful sense offset by restricting farm mortgage credit in Iowa. The latter would simply mean that men and equipment will remain idle that might otherwise have been employed in making goods and services. In the later stages of a war or armaments program, when most commodities have become scarce, the creation of such local pools of unemployment might be justified because of their comparative unimportance in relation to the areas of scarcity, and because of the administrative simplicity of over-all credit restriction as opposed to attempts to control the demand for each scarce commodity separately (by taxes, rationing, or other devices).

In spite of his underlying misconception as to the nature of price inflation, Hardy has several useful suggestions for preventing it. He first discusses steps to increase the supply of scarce commodities by encouraging imports. Under this heading are suggestions for lowering tariffs, exporting gold and silver, and using exchange control in order to increase the buying power of the dollar in terms of foreign currencies.

Passing to price control proper, he stresses the importance of centralized purchasing by the Government (and its allies, if any). In the case of commodities made to Government specifications, price control must take the form of stern bargaining by the purchasing authority. Difficult problems arise chiefly in the case of standardized commodities having an important civilian market. Hardy is critical of the bulk-line method used in the World War, since it led to excessive profits for all but the highest cost producers. He points out that reliance on the excess profits tax to recapture these high earnings was not justified. Instead of this procedure he suggests a "public utility" method under which the price paid to each firm would be determined by an individual contract based on its costs. That is, standardized commodities would be bought as if they were being produced to specification. After Government requirements had been met, the remaining supply would be sold on the civilian market for whatever price it would bring. (Presumably it would be necessary to require low-cost producers to accept Government orders instead of selling their supplies on civilian markets at the higher prices obtainable there.)

Hardy is opposed in general to the fixing of civilian prices, although recognizing that it may in some cases be necessary. When control is to be undertaken, he suggests adoption of a method similar to that used in the case of sugar in 1918. The Sugar Equalization Board bought sugar at various prices from producers and resold it to the public at a uniform price. Thus it was possible to adjust the receipts of producers to their varying costs without trying to sell the same commodity at different prices in the same market.

Hardy concludes that, although fiscal policy was incorrect, price control during the World War "was basically sound and that, in view of the difficult conditions under which it was applied, it was reasonably effective." (p. 211)